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CHARLES ELMORE CROPLEY
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IN THE

Supreme Court of the United States

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STEPHEN W[illegible], Trustee in Bankruptcy of Grand Avenue Lumber Company, a corporation, Bankrupt,

Petitioner,
(Appellant Below)

vs.

[illegible]

[illegible]

A[illegible] B. B[illegible],
Counsel for Petitioner.

[illegible]

INDEX

AUTHORITIES CITED

STATUTES CITED

RULES CITED

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No...

STEPHEN WESTOVER, Trustee in Bankruptcy of Grand Avenue Lumber Company, a corporation, Bankrupt,

Petitioner,
(Appellee Below)

vs.

VALLEY NATIONAL BANK, a banking corporation,

Respondent,
(Appellant Below)

PETITION FOR WRIT OF CERTIORARI TO REVIEW THE DECISION OF THE CIRCURT COURT OF APPEALS FOR THE NINTH CIRCUIT.

TO THE HONORABLE, THE SUPREME COURT OF THE UNITED STATES:

The petition of Stephen Westover, trustee in bankruptcy, respectfully shows to this Court as follows:

This is a petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit, upon the ground that the questions presented are of grave importance to the public and especially to creditors, in the interest of fair and equitable ad-

ministration of bankrupt estates, involving the construction of the Bankruptcy Act, the Circuit Court of Appeals having reversed the judgment of the trial court based upon findings of all the facts necessary to sustain recovery of a voidable preference in an action tried without a jury, and promulgated an erroneous rule by holding that a trustee in bankruptcy *must*, in order to recover a voidable preference, establish knowledge of the one receiving the transfer *that it was intended as a preference*, notwithstanding the plain and unambiguous language of Section 60b of the Bankruptcy Act of 1898, as amended to June 26, 1936, (being the law in effect at the time of the transfer) that the transfer may be avoided by the trustee if the one receiving it has reasonable cause to believe the enforcement of the transfer would effect a preference.

The several reasons relied upon are set forth with more particularity hereinafter.

A certified copy of the proceedings in the District Court and the Circuit Court of Appeals is presented herewith. References to same are indicated by the designation (Tr.).

PRELIMINARY STATEMENT

On an involuntary petition in bankruptcy, filed on January 12, 1938, the Grand Avenue Lumber Company, a corporation, was adjudicated bankrupt on February 3, 1938 and on February 19, 1938, Stephen Westover was appointed and qualified as trustee (Tr. 3). From November 22, 1937 up to the bankruptcy, the company was in the hands of a receiver appointed by the Superior Court of Maricopa County, Arizona, in a suit brought against it on that day by the Arizona Concrete Company, a corporation of which, S. B.

Shumway, the president and controlling stockholder of the bankrupt, was vice president and also controlling stockholder, the suit being filed upon his instructions (Tr. 292).

On September 23, 1938 the trustee in bankruptcy instituted suit in the United States District Court of Arizona against the Valley National Bank to recover as voidable preferences two payments made to the bank by the bankrupt, one on October 13, 1937, for $3,040 and one on November 22, 1937 for $3532.99, both payments being on notes not due at the time, and together covering payment of all indebtedness to the bank (Tr. 2, 8). The case was tried to the court, without a jury, and on July 11, 1939, judgment was entered and filed in favor of the trustee for the full amount asked, based on findings of fact covering all the elements of voidable preference (Tr. 37-46).

Motion for new trial was filed by the bank and denied October 19, 1939 (Tr. 50). No petition for amendment of the findings was filed by the bank. Appeal was taken by the bank, and the Circuit Court of Appeals on May 22, 1940 rendered its opinion and entered its judgment reversing the judgment of the trial court and entering judgment for the bank (Tr. 345). Motion for rehearing was filed by the trustee in due time, and on June 19, 1940, the same was denied, the order directing a modification of the opinion, but making no change in the judgment (Tr. 346). The court, however, on application granted a stay of proceedings on the mandate, pending the decision on an application to be made to this Court for a Writ of Certiorari (Tr. 347). The opinion is reported in 112 Fed. (2) 61 (Advance Sheets, Vol. 1, July 8, 1940).

STATEMENT OF MATTERS INVOLVED

The case was tried to the court below without a jury, a jury having been waived by the parties by stipulation, and the trial court made written findings of fact and conclusions of law based thereon. Objections to said findings were not filed within the time required by Rule 21, District Court Rules, District of Arizona. No request to amend the findings was made by appellant under the provisions of Rule 52 (b) of the Federal Rules of Civil Procedure.

The trial court entered judgment in favor of the trustee in bankruptcy of Grand Avenue Lumber Company, a corporation, and against the Valley National Bank, of Phoenix, Arizona, for recovery of preferential payments made to said bank within four months prior to the adjudication in bankruptcy and entered written findings of fact covering all the elements of voidable preference, including finding XIII, reading as follows:

> "That at the time said payments were made by said Grand Avenue Lumber Company, a corporation, to said Valley National Bank on, to-wit, October 13, 1937, and November 22, 1937, the said Valley National Bank had reasonable cause to believe that the said Grand Avenue Lumber Company, a corporation, was insolvent, and that the said payments of said amounts to it would enable it to receive a greater percentage of its debt than some other creditors of said Grand Avenue Lumber Company, a corporation, of the same class;" (Tr. 25)

Appellant, in its statement of points on which it intended to rely on appeal, challenged this finding, among others, in the following manner:

"That the trial court erred in Finding of Fact Number XIII, by finding that The Valley National Bank had reasonable cause to believe that the Grand Avenue Lumber Company, a corporation, was insolvent on October 13, 1937, and November 22, 1937, or on either of said dates, *for the reason that it had every reason to believe that Shumway, who was not insolvent, was standing back of the Grand Avenue Lumber Company.*" (Italics ours) (Tr. 332)

The United States Circuit Court of Appeals, in its opinion filed May 22, 1940, and as modified June 19, 1940, reversed the judgment and ordered judgment for appellant upon the following ground:

"The judgment must be reversed and judgment awarded the appellant upon the ground that the trustee has failed to establish *knowledge*, actual or constructive, *of the bank* that the payments made to it *were intended as a preference.*" (Italics ours) (Tr. 344)

In the situation of this record the appellate court could only review the sufficiency of the evidence to support the judgment as provided in Rule 52, Federal Rules of Civil Procedure. The reversal of the judgment as will be noted is grounded entirely upon the alleged failure of the trustee in bankruptcy to establish *one* element of voidable preference required by the Bankruptcy Act, being that part of Section 60b of the Bankruptcy Act, as amended to June 26, 1936, in effect in the year 1937, italicized in the following excerpt therefrom:

"And if at the time of the transfer * * * the bankrupt be insolvent and the judgment or trans-

> fer then operate as a preference, *and the person receiving it or to be benefited thereby, or his agent acting therein, shall then have reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference,* it shall be voidable by the trustee."

Since the insolvency of the bankrupt at the time of the payments must be conceded, and is not questioned in the opinion, the only element of voidable preference upon which the appellate court presumes to have found the proof insufficient was Finding of Fact XIII of the trial court, cited above, by the wrongful construction that it placed on the provision of the Bankruptcy Act above cited, with respect to proof thereof.

In giving its ground for reversal the court clearly placed upon the trustee the wholly unnecessary and difficult burden of proving knowledge, actual or constructive, on the part of the bank or its agent *that the payments were intended as a preference.* This was clearly erroneous.

From and after the amendment in 1903 to the Bankruptcy Act of 1898, it was necessary in order to make a preference voidable to show that the creditor *had reasonable cause to believe that a preference was intended.* However, in 1910 the Bankruptcy Act was amended to read as above stated and the transfer *is voidable by the trustee without regard to the factor of intent.*

It is very apparent from many statements all through the opinion that the reviewing court was construing the burden placed upon the trustee in the light of the requirements of the Bankruptcy Act *prior to*

1910 and the consideration of cases submitted in appellant's brief which were decided under the provisions of the law prior to its change in 1910 and which emphasized the necessity of proving "intent" in order to establish voidable preference.

It is also apparent that the court placed upon the trustee the burden of proving *knowledge* by the bank of the insolvency of the debtor, rather than the requirement of the statute of "reasonable cause to believe." This, too, is clearly erroneous.

The statement of the court in its opinion (Tr. 339) that "two circumstances are strongly relied upon by the trustee to sustain the finding of the trial court that the appellant knew that the bankrupt was insolvent when it accepted payment," after which these "two circumstances" are presumably set forth and reviewed, does not fairly state the record. In the first place, the finding was, in the language of the Bankruptcy Act, that the appellant "had reasonable cause to believe" the Grand Avenue Lumber Company was insolvent, a vastly different matter from *knowledge*, and in the second place, not only were there *numerous other circumstances* on which reliance was placed, but these two circumstances are not stated strictly in accordance with the evidence, many of their essential elements from which inferences would naturally flow having been emasculated in their narration.

The trustee showed by undisputed evidence in the record the following facts sufficient to put the bank, through Carl Gibson, its agent in the transaction, on inquiry which would have revealed the company was hopelessly insolvent at the time of the payments.

The Grand Avenue Lumber Company was a corporation which was organized and started business in Phoenix, Arizona during July, 1936. S. B. Shumway was the president of the company and its controlling stockholder (Tr. 106). The company engaged in a general lumber and contracting business in a small way. The entire paid up capital stock of the corporation was $3625.00 (Tr. 210). In July, 1936 the company commenced borrowing money from the Valley National Bank, two loans being made during July and August of that year which were paid. In September, 1936, two more loans in the amount of $500.00 each were made without security or co-maker, these loans being paid at maturity (Tr. 154, 155). In the spring of 1937, about May 1st, the company began to go into the expansion of building homes under the F. H. A. and of making sales campaigns expanding business with little or no margin of profit and from that time on, according to the testimony of a certified public accountant, the concern lost money (Tr. 209). In the spring of 1937, S. B. Shumway told at least one creditor that he was going to get a loan of about $20,000 from the Valley National Bank in order to put more money into the business as there was not enough capital in the business (Tr. 184). The company continued to borrow money from the Valley National Bank, but commencing in March, 1937, the loans were in considerably larger amounts and from that time loans were made in varying amounts but no loans were made *except with S. B. Shumway as co-maker.* The indebtedness varied from $3500 up to as much as $6500. This indebtedness was all paid during the fall of 1937, one payment on October 13, 1937, paying a note of $3,000, which note the records showed was not due until No-

vember 13, 1937, and another payment of $3532.99 paid on November 22, 1937, paying a two thousand dollar note and a fifteen hundred dollar note, neither of which were due at the time of payment (Tr. 155). The last two payments which it is contended were preferential were the only payments shown on the loan sheet of the bank to have been made before the notes were due (Tr. 314). The bankrupt estate could not pay other unsecured creditors in full (Tr. 168).

All credit relations between the bankrupt and the bank during the entire period were through its president, S. B. Shumway, and Carl Gibson, the vice president of the Valley National Bank (Tr. 292). No other officer or employee of the bank had any "contact" with the Grand Avenue Lumber Company or with S. B. Shumway in connection with loans or payments (Tr. 308, 311).

S. B. Shumway testified as follows:

> "Q. Mr. Shumway, with whom at the Valley Bank did you have credit relations; with what officer of the Valley Bank was your credit as President of the Grand Avenue Lumber Company, for the Grand Avenue Lumber Company? With whom did you discuss your transactions?
>
> "A. I discussed *all my business and the business I did and any concern I did business with, with Mr. Carl Gibson at that time.*" (Tr. 292) (Italics ours)

An audit was made up for the Grand Avenue Lumber Company for the fiscal year ending July 1st, 1937, which showed profits of $9,000 and on which a dividend of that amount was paid, but this audit did not

correctly state the profits. Matters showing its true condition were all revealed on the books of the company (Tr. 214). Income tax was paid on only $4200 instead of $9,000 (Tr. 213). This audit was in the files of the Valley National Bank during the fall of 1937. It showed what a creditor of the company stated as a "complicated" situation regarding accounts receivable and accounts payable (Tr. 296, 297).

During the summer of 1937 Shumway went to California for a vacation and before leaving arranged with Carl Gibson for loans to take care of current expenses during the summer and left *with Carl Gibson at the bank* blank notes signed by him, as president of the company, and individually (Tr. 111). Shumway directed Wright, the manager and treasurer of the company, if the bank account got low and money was needed to pay current expenses to go to the bank, get the necessary notes from Gibson, sign them as treasurer of the company, and deposit the money to the account of the Company (Tr. 111). On August 12, 1938, Wright went to the bank and saw Gibson, told him money was needed for current expenses and Gibson gave him two one thousand dollar notes already signed by Shumway, which Wright signed, and then deposited the amount of $2,000 to the account of the company on that date (Tr. 112). This was less than six weeks after the "audit" of June 30, 1937, was made upon which a dividend of $9,000 had been paid, —the greater part to Shumway,—out of "reputed" profits.

A few days *after August 12th*, 1937 Gus E. Engstrom, manager of the Arizona Sash, Door & Glass Company, a creditor of the Grand Avenue Lumber

Company, went to the bank and talked with Carl Gibson as an officer of the bank to try to find out the financial condition of the Grand Avenue Lumber Company, stating he was worried about his account and could get no satisfaction from Wright or Shumway. Engstrom's testimony as to his conversation with Carl Gibson on that occasion is as follows:

> "Why, I told Mr. Gibson that the Grand Avenue Lumber Company owed us a considerable account and that I was not able to get any satisfaction from Mr. Shumway or Mr. Wright as to payment, and that we were considering taking some action to collect that account and I would appreciate any information he could give me as to their financial standing. He then asked me how much the Grand Avenue Lumber Company owed us and I told him it was approximately $3,000.00. He said, *That is entirely too much, and there are several other accounts that are in the same condition.* I then asked him if we took action, in his opinion, did he think we could collect that amount? He said, 'I would suggest you would not do anything about it right now. Mr. Shumway is in California. *I will get in touch with him and have him come over here* and see if he won't put your account in better condition'. I said, 'When will you do that?' He said, 'At once', and I then asked him if he would notify me when Mr. Shumway came back, and he said he would, and that was the sum and substance of the conversation." (Tr. 219). And again, "the way he talked it seemed he was handling the affairs of Mr. Shumway." (Tr. 226). (Italics ours).

Engstrom reported his conversation to the officers and attorney of his company and a couple of days later Gene Cunningham, the attorney for the company, also saw Carl Gibson, stating it had been his intention to immediately sue the company. Gibson asked him not to do that and said: "Don't do that. Mr. Shumway is now on the Coast recuperating from *an illness and I will get him right back here.*" (Tr. 229). A few days later Shumway returned and Cunningham saw him at Gibson's desk in the bank, talking to Gibson (Tr. 230). On the 26th of August the Grand Avenue Lumber Company made a payment on account of this claim to the Arizona Sash, Door & Glass Company of $1562.70 (Tr. 124). It continued to extend credit based on the belief of Engstrom from his conversation with him that Carl Gibson was handling Shumway's affairs (Tr. 219).

On September 20, 1937. the Grand Avenue Lumber Company, through Shumway, made application to the Valley National Bank for a loan of $20,000 (Tr. 312). At that time the loan sheet showed $6500 was owing by the Grand Avenue Lumber Company to the bank (Tr. 155). The loan of $20,000 was refused *solely on the recommendation of Carl Gibson* (Tr. 311, 318). The records of the bank, produced on the trial, merely showed with respect to this application the notation "too large for the capital" (Tr. 312). All the officers of the bank who testified said unhesitatingly that no officer of the bank other than Carl Gibson had any connection with the transaction, and none had personal knowledge of same, and the loan was refused by the loan board on his written memorandum without discussion. So far as the records disclosed, no investigation was made by the bank of its loan

account except such investigation as might have been made by Carl Gibson and routine "statements" twice a year (Tr. 308, 311, 318). Carl Gibson died before the trial of the case (Tr. 118).

On October 13, 1937, twenty-three days after the application for this $20,000 loan and its refusal by the bank, the loan sheet shows the Grand Avenue Lumber Company paid to the bank its note of $3,000 with interest, *thirty days before its due date* (Tr. 155). Although the check in payment of this note is dated October 7, 1937 (Tr. 130), it apparently did not clear the note teller's window until the 13th (Tr. 155), on which date payment was credited. The payment was made on the order of Mr. Shumway (Tr. 129), although at that time the company was unable to meet its current obligations (Tr. 144).

During September or October of 1937, the Grand Avenue Lumber Company also negotiated with the Occidental Life Insurance Company for a loan of $20,000 and after investigation that loan was refused (Tr. 147, 149).

The bankrupt was insolvent for three months before November 22, 1937 and its condition was disclosed by its books (Tr. 200, 214). On November 22, 1937, the deficiency in the company's assets at a fair valuation to meet its liabilities was not less than $20,000 (Tr. 175, 200). It had been losing money from about May 1st of that year (Tr. 209) and had difficulty over credit because of inability to pay current bills from May 1st up to the time of the receivership on November 22nd. Several concerns cut off credit altogether during that period and during September, October and November, 1937, the company

was having difficulty in getting materials for jobs (Tr. 182, 184). Suits were threatened during this period (Tr. 294).

As of November 22, 1937, the books showed total accounts receivable were $57,975.90, and the accounts payable were $59,240.28 (Tr. 82, 101). Many of the accounts receivable were then three or four months past due; some were secured by mechanic's liens and would involve litigation to collect (Tr. 100, 207).

On November 22, 1937, Shumway personally took to the bank all collections of the Grand Avenue Lumber Company which had been made for several days previous, deposited in the account of the Grand Avenue Lumber Company the amount of $3533.72 and immediately gave to the bank a check for $3532.99, paying up all indebtedness to the bank consisting of one note for $2,000 and another for $1500, together with interest, neither of which notes were due at that time. The check for this payment to the Valley National Bank had been signed in blank several days before by C. L. Wright, as treasurer, upon Shumway's instructions and by him given to Shumway (Tr. 131-138). It was handed to the bank by Shumway on November 22nd, but to whom it was delivered at the bank is not disclosed by the evidence (Tr. 322). The notes were delivered to Shumway but were never produced by him (Tr. 291). On the same day he made this payment, November 22nd, suit for receivership of the bankrupt was filed on Shumway's direction through a company of which he was vice president and a receiver was appointed but whether this had been done *before or after the payment* is also not disclosed by the evidence (Tr. 292).

As is noted in appellant's challenge to Finding XIII of the trial court, it was contended that the bank did not have reasonable cause to believe the debtor insolvent because it believed "Shumway who was not insolvent was standing behind it". There was no evidence whatever as to Shumway's solvency or insolvency. It was not an issue and this "belief", if the bank had it, could not alter its legal liability, for it presumably knew that Shumway was not liable for a corporation debt *since the bank took the precaution to get Shumway's personal signature on all its paper* (Tr. 314). That the appellate court took into consideration this entirely extraneous contention in arriving at its inference that the bank had no *knowledge* of insolvency is indicated by its language in the opinion that Shumway was a "man of some means" (Tr. 340). There was no evidence of Shumway's financial status and that he managed to do very well for himself out of the Grand Avenue Lumber Company during its brief existence (at the expense of creditors *other than the bank)* through receiving an exorbitant dividend on an inflated statement of profits (Tr. 213) does not, of course, justify any conclusion as to his actual "means".

The following instances of erroneous or confused statements of the facts, contained in the opinion of the appellate court (Tr. 338-344) are cited, together with applicable references to the record, showing the discrepancies in same.

(1) The statement in the early part of the decision (Tr. 339, line 8) that the payments in question were *not made to Carl Gibson,* vice president of the bank. This is only an assumption, not a fact established by the evidence.

There is no evidence in the record to show to whom these payments were actually made. Carl Gibson died subsequent to the payments and before the trial. The assistant cashier of the bank, who was also note teller in October and November, 1937, testified on direct examination that he "thought" he received the payments (Tr. 322) and on cross-examination testified:

> "Q. Mr. Boyd, you said you *thought* that those payments came through your hands. Do you have any independent recollection of it other than your records there? "A. Nothing but my records and the fact I was Note-Teller and received practically all the payments and I saw the loan journal sheets.
>
> "Q. There are others on that desk occasionally, are there? A. At that time, I believe there was.
>
> "Q. And you have no independent recollection of either of these payments, then? A. No. ma'am.
>
> "Q. The only thing you are testifying to in regard to those notes is from your records there and without any independent recollection of it? A. That is correct." (Tr. 323-324).

G. C. TAYLOR, vice president of the bank, testified (Tr. 308) that "the officer who would have had direct knowledge concerning this loan was Mr. Carl Gibson", and that (Tr. 311) "he (Carl Gibson) had all contacts with the borrower". And Mr. Shumway, who was the officer of the bankrupt who, it was shown, handled all business concerning these loans with the bank, testified with respect to his credit relations with the bank (Tr. 292) "I discussed all my business and the business I did and any concern I did business with,

with Mr. Carl Gibson at that time". And it is significant that although the check for the October payment is *dated* October 7th, it did not clear the teller's desk until the date of *October 13th.*

From all of this it will be seen that a reasonable person might perhaps more readily draw from the undisputed evidence the conclusion that the payments were made to Carl Gibson and by him turned in to the note teller than that they were actually made to the note teller at the window, and certainly from Shumway's statement above given they must have been *discussed* with Gibson. In any event, there is *no evidence* justifying the statement in the opinion that the payments in question were *not* made to Carl Gibson.

(2 The statement (Tr. 340) that "immediately after the payment of the second note to the bank on November 22, 1937, at the instance of S. B. Shumway, the business of the bankrupt was placed in the hands of an equity receiver appointed by a state court."

There is nothing whatever in the evidence to disclose that the business of the bankrupt was placed in the hands of a receiver *after* the payment of the notes, as the only evidence was that the receivership application, based on a suit on a debt commenced by another corporation of which Shumway had control was filed on November 22, 1937, the same day as the payment (Tr. 292). Nothing is revealed by the evidence as to the time of day of the filing of the suit or the payment to the bank. This is clearly an assumption of a material fact not shown by the record.

(3) The statement that S. B. Shumway was " a man of some means" (Tr. 340, line 2) is entirely a

deduction of the court as there was no evidence relating to the subject of Shumway's "means".

(4) The statement that certain liabilities were "scheduled in the receivership" at $60,816.72 (Tr. 340). No schedules of the receivership were even referred to in the evidence.

(5) The statement (Tr. 340) that "it was developed during the bankruptcy proceedings which were inaugurated January 12, 1938, that there were *two* other items of indebtedness owing by the company on November 22, 1937. One was for $4,039.01 evidenced by a promissory note payable to the Arizona Concrete Company. The other for $4,321.72 was due to the president of the bankrupt, S. B. Shumway".

The undisputed testimony of the trustee in bankruptcy (Tr. 169, 170) was that in addition to the liabilities listed in the bankrupt's schedules, which aggregated $69,177.45, (and which latter amount included the *two* items mentioned in the above excerpt from the opinion) he had found there were *three* additional items of indebtedness outstanding on November 22, 1937 to be added to that amount, one to R. G. Chipperfield in the amount of $4832.55, one to the Arizona Tax Commission for $694.00 and one to the Fidelity Life Insurance Company for $981.35, aggregating a total amount of $6,507.90 of indebtedness "developed during bankruptcy proceedings" *in addition to the amounts stated in the opinion.*

(6) The statement that "appellee claims at book value total assets of $76,958.76, liabilities of at least $75,685.35 on November 22nd 1937" (Tr. 340).

This is incorrect. The figures asserted by appellee,

based on undisputed evidence in the record and which were clearly stated therein and also in appellee's brief, showed items of $2557.77 for discounts and $375.79 for "prepaid insurance" to be deducted from assets scheduled by the bankrupt as $76,958.76, thus placing at "book value" the assets "claimed" by the appellee on November 22, 1937 at $74,025.20, instead of $76,958.76, as stated in the opinion, and showing a deficiency in assets to meet liabilities, *even at book value*, of $1660.15 on November 22, 1937, (Tr. 173, 174).

(7) The statement that "as late as June 30, 1937, the bankrupt paid a substantial dividend and *paid income taxes upon a profit of about $9000*" (Tr. 341).

Income tax was only paid on $4200 for the fiscal year ending June 30, 1937.

James A. Smith, a certified public accountant, on redirect examination (Tr. 213) testified as follows:

> "Q. Mr. Gust asked you about the apparent profit which was shown by the report that was filed or made as of June 30th, 1937, on which a dividend of $9,000.00 was paid. What were your findings in regard to the amount of profit or loss; was that a profit according——
>
> "A. My findings were that that profit was overstated by something like $4,800.00. Without going into any factor of bad debts or without going into the factor of actual inventory as against the estimated inventory used on the basis of the report of which Mr. Gust referred. I submitted those findings to the Department of Internal Revenue of the United States and to the Income Di-

vision of the State of Arizona *and asked for a refund of taxes that had been paid or were then stated as owing upon the income of $9,000.00, and in each case the two taxing bodies reinstated to us the amount of taxes which had been paid in error* based on the original computation of Mr. Bailey's report.

"Q. I mean the recovery of the taxes was the difference between what, your figures and Mr. Bailey's? A. About $4,800.00 difference."

There was no evidence in conflict with this.

(8) The statement inserted in the opinion on its modification order of June 19, 1940 (Tr. 341) reading as follows:

> "Thus, bills receivable having a face value of $45,785.72, were appraised at $30,206.06, a reduction of $15,024.90."

contains a statment of only *part* of the appraisal of "accounts receivable" and omits other accounts receivable shown on the appraisal referred to (Tr. 282) aggregating $3614.34 at face value, appraised at $2,051.00. Thus a correct statement of the appraisal of the "accounts receivable", as shown by the record and which were all part of those listed in the schedules of the bankrupt as of a value of $57,975.90 (Tr. 165) would be "accounts receivable having a face value of $49,400.06, were appraised at $32,257.06, a reduction of $17,143.00" (Tr. 282, 289).

(9) The statement that "an expert accountant testified that the bankrupt made a profit *up to June 30, 1937*, but that *shortly thereafter it changed its method of doing business.*" (Tr. 342)

The testimony of the expert accountant referred to upon cross-examination was (Tr. 209) as follows:

> "Q. Was that your own testimony here, that you thought that it made money when it first organized? A. Yes, when it first organized, but *as of June 30th*, they had been losing money.
>
> "Q. Can you fix the time about when they began to lose money? A. I would fix the time at approximately *the first of May;* that is, the Spring of 1937, when they began to go into the expansion of building homes under the FHA and other plans of making concerted sales campaigns."

(10) The statement that "the expert accountant, called as a witness testified that there was no change in the method of doing business during the period under consideration which would give notice to a *casual observer* that the company was in any financial difficulty" (Tr. 342).

The testimony of the expert accountant under cross examination upon which this statement was evidently based was as follows: (Tr. 212).

> "Q. I refer now to November 22d, it was an operating concern? A. It was, yes.
>
> "Q. As far as any person, a casual person knew, not an expert such as yourself and so on, there was no way of knowing that they were not going along perfectly all right? A. I think a *casual observer,* yes, would have believed that the concern was going along all right *unless they made inquiry.*"

(11) The statement (Tr. 342) that "the loan of

August 12, 1937, of $2,000.00 was made by the appellant to the bankrupt while this matter was pending" (referring to the time the attorney for the Arizona Sash, Door & Glass Company spoke to Gibson about that matter).

The testimony of Gene Cunningham, attorney for the Arizona Sash, Door & Glass Company, as to the time when he saw Carl Gibson (Tr. 231) is as follows, "as well as I am able to, I would make it after the 17th of August, after the 17th of August and before the 24th". Thus it was *at least five days after* the loan was made before the attorney even went to see Gibson.

(12) The statement that a short time after August 26, 1937, a second payment of $900 was made to the Arizona Sash, Door & Glass Company (Tr. 342).

The evidence shows a payment of *$830.87* was made to that company on September 20, 1937 (Tr. 225), the only payment made after August 26th.

(13) The statement that an audit upon which "dividends were paid was brought to the knowledge of, and was considered by, the bank at the time two loans aggregating $2,000.00 were made by it to the bankrupt upon promissory notes with S. B. Shumway as comaker" (Tr. 341-342) is also inferential.

There is no evidence that this audit was "considered" by the bank at the time any particular loans were made. It was testified in connection with the application for the loan of $20,000, *which was refused on September 20, 1937*, merely that the audit was in the file of the bank (Tr. 313, 317).

(14) The statement that (referring to the application for loan of $20,000 from the bank on September 20, 1937) "as this loan was larger in amount than the stock carried by the bankrupt" (Tr. 343).

There was no evidence in the record of what amount of stock was carried by the bankrupt, on or before September 20, 1937. The only evidence in the record concerned stock on hand and inventoried as of *November 22, 1937*, at the time of the receivership (Tr. 144) and was set forth in schedules of the bankrupt not filed until March 8, 1938 (Tr. 102).

(15) The statement that "the appellant had no knowledge of impending receivership at the time it accepted the payment of November 22nd. Several of the officers of the bank who had to do with the credit departments of the bank were called by the defendant, *including the one to whom the payments in question were made*" (Tr. 343).

The following is testimony of officers of the bank as shown by the record:

G. C. TAYLOR (Direct)

"Q. Are you testifying from your personal knowledge of this loan or from the records only?

"A. The Witness: I am testifying from the records of the bank.

"Q. You have no personal knowledge of the making of this? A. Except as a routine matter. All loans handled are through an Executive Committee.

"Q. Who was the one with whom—by whom those loans were made; what official of the bank?

"A. Mr. Gibson." (Tr. 304, 305).

"Q. Mr. Taylor, did you at any time have any knowledge of the fact that the—there was going to be a receivership with this company prior to the date the last payment was made? A. I did not. (Tr. 307).

"Q. Do you have any recollection of anything being brought up concerning this loan? A. I do not.

"Q. The officer who would have had direct knowledge concerning this loan was Mr. Carl Gibson? A. Correct.

"Q. And is he now deceased? A. Correct. (Tr. 308).

CROSS EXAMINATION

"Q. And you testified, I believe before, that these loans were all made through Mr. Gibson? A. That is right.

"Q. And he was the one who investigated the credit for this particular loan, is that correct? A. *He had all contacts with the borrower.*

"Q. And the loan was passed on by the committee, on his recommendation, generally speaking? A. That is correct, yes." (Tr. 311).

JOHN G. BOYD (Direct)

"Q. I will ask you if you are the man who received the payments that were made on the notes of the Grand Avenue Lumber Company during those two months? A. I *think so*, yes, sir.

"Q. Have you the record there showing the payments made on October 13, 1937? A. Well, *I find a note of $3000.00 was paid that day.*

"Q. Did you receive the money? A. Yes, sir; *I think I did.*

"Q. At that time, did anything come to your attention concerning the matter that you thought unusual? A. No, Sir." (Tr. 322).

CROSS EXAMINATION

"Q. Mr. Boyd, you said you *thought* that those payments came through your hands. Do you have any independent recollection of it other than your records there?

"A. Nothing but my records and the fact I was Note-Teller and received practically all the payments and I saw the loan journal sheets.

"Q. There are others on that desk, occasionally are there? A. At that time, I believe there was.

"Q. And you have no independent recollection of either of these payments, then? A. No, ma'am.

"Q. You said, I believe in answer to Mr. Gust's question, that there was nothing unusual in paying a note before it is due. Would you think it was unusual to pay a note before it was due on the same day that a petition in receivership was filed? A. If I knew it, I think it would be a little bit unusual.

"Q. It was not customary, then? A. No. I would say it was not.

"Q. The only thing you are testifying to in regard to those notes is from your records there and without any independent recollection of it? A. That is correct." (Tr. 323, 324)

"Q. You were present at the meetings? A. Yes.

"Q. At all those meetings, was the matter of the loan of the Grand Avenue Lumber Company brought up for discussion? A. Other than the application that Mr. Taylor mentioned?

"Q. That is, the application for a loan? A. The application for a loan, but for the loan itself that occurred, I do not remember." (Tr. 318). (Italics all ours)

From this it will be seen that the testimony referred to in the opinion was wholly negative and that it is incorrect to say it included the "one to whom the payment were made" since there is no evidence as to whom payment was actually made.

Two other manifest errors of statement contained in the original opinion and pointed out in appellee's motion for rehearing were corrected by the modification of June 19, 1940. One of these was a misstatement in appraisal figures involving many thousands of dollars of valuation (Tr. 346), and, as stated above, only *part* of the appraisal figures of "accounts receivable" is given through the modification in the opinion as it now stands.

It is therefore urged that the appellate court so misinterpreted and failed to properly evaluate undisputed, competent evidence shown by the record, and upon which the trial judge who heard the testimony based his findings of fact, as to call for the exercise of the supervision of this court in the interests of justice to the creditors of a bankrupt estate. Not only does it appear that much material evidence was wholly ig-

nored but the opinion discloses an assumption as facts of many matters which an examination of the record will show are clearly incorrect, while others are shown to be entirely conclusions, without any evidence whatever to justify them.

Although some of these erroneous statements, which will be considered later, might seem immaterial to the findings, yet others go to the very core of the proof necessary to establish voidable preferences, and taken together and in connection with the other material testimony which was obviously disregarded, they clearly indicate that not only was the evidence most *casually* examined and its true purport quite confused, but that it was considered upon a wrongful hypothesis of the extent of the burden of proof placed on the trustee in order to establish a voidable preference, predicated upon the mistaken assumption that the trustee was required to prove both that the bank had knowledge of "intent to prefer" by the payment (which is entirely unnecessary) and "knowledge of insolvency of the debtor" rather than "reasonable cause to believe" the debtor insolvent,—the latter being the language of the Bankruptcy Act and a matter which may be established by proof of *notice of facts sufficient to put a prudent man on inquiry* if such an inquiry would have revealed insolvency, as has been long recognized by the weight of authority.

Carl Gibson was no "casual observer" of the affairs of this company for the evidence disclosed a close relationship with the president of the bankrupt over a period of the entire life of the concern, shown by the testimony of the bankrupt's president "I discussed all my business and the business I did and any concern

I did business with, with Mr. Carl Gibson at that time" (Tr. 292), and by the testimony of Gus Engstrom the creditor who consulted Carl Gibson about the financial responsibility of the bankrupt that "the way he talked it seemed he was handling the affairs of Mr. Shumway" (Tr. 226). That an investigation would have disclosed hopeless insolvency over a period of many months to anyone *who made inquiry* cannot be seriously suggested.

It is also urged that the plain meaning and intent of the provision of Rule 52 (a), Federal Rules of Civil Procedure, with respect to actions tried upon the facts without a jury that "findings of fact shall not be set aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses" were entirely disregarded and that the appellate court in effect substituted its judgment on facts for that of the trial court and without a clear and correct understanding of those facts. No error was assigned to the admission of any of the evidence, and it was undisputed. Much of it consisted of figures going to valuations contained in voluminous schedules and records, which were introduced in connection with oral testimony of witnesses concerning the same. A proper understanding of the entire evidence from the cold pages of a record necessitated an exhaustive and painstaking examination and consideration, and even then could not be as well understood as by anyone hearing the testimony with the references pointed out by the witness.

The language of Rule 52 (a), Federal Rules of Civil Procedure, indicates that an appellate court before assuming to hold a finding of fact of a trial judge who

heard and considered all the evidence to be "clearly erroneous" because its viewpoint differs from that of the trial judge on the conclusions which might be drawn from unchallenged evidence, should unquestionably have a clear, correct and considered concept of all the evidence upon which the trial judge based his finding and of the applicable provisions of the Bankruptcy Act of the proof required to sustain it.

Certainly under the rule laid down by this Court prior to the adoption of Rule 52, of the Federal Rules of Civil Procedure, and consistently adhered to in an unbroken line of decisions that where a case is tried by the court, a jury having been waived, *its findings upon questions of fact are conclusive and not subject to revision by circuit courts of appeal*, the action of the appellate court would clearly be erroneous.

Petitioner submits that the judgment of the Circuit Court of Appeals, reversing the judgment of the trial court based on findings of fact, thereby promulgating a rule which places an incorrect and unnecessary burden of proof upon the trustee in bankruptcy in establishing a voidable preference, and failing to consider and properly evaluate competent, material evidence in the record as is clearly shown by the language of its opinion, is so clearly erroneous as to call for the exercise of the power of supervision of this Honorable Court.

QUESTIONS WHICH PETITIONER SEEKS TO HAVE DETERMINED BY THIS COURT.

FIRST: Was the burden placed upon the trustee in bankruptcy, in order to effect a recovery from a bank of a voidable preference under the provisions of Sec-

tion 60b of the Bankruptcy Act of 1898, as amended to June 26, 1936, to establish that the bank had "knowledge, actual or constructive, that the payments made to it *were intended as a preference*," all the other elements of voidable preference being admittedly established and the language of the said Bankruptcy Act providing that the trustee may recover "if the person receiving it or to be benefited thereby, or his agent acting therein, *shall then have reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference*"?

SECOND: Must a trustee, in order to recover from a bank a payment otherwise voidable as preferential, establish "*knowledge*" by the bank of the debtor's insolvency at the time of payment, or is it sufficient if he establishes that facts were known to the officer of the bank who was handling the loans to the debtor at the time of the payment that would have put a reasonably prudent person upon inquiry and that such an inquiry would have disclosed insolvency?

THIRD: Does Rule 52 (a) Federal Rules of Civil Procedure, providing that "findings of fact shall not be set aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses", change the rule long established by this Court that the findings of the trial court, where a jury has been waived, are conclusive upon questions of fact, and permit the Circuit Court of Appeals to substitute its judgment on facts for that of the trial court because it draws different inferences from facts from those drawn therefrom by the trial court, and where its inferences are

based on an erroneous conclusion as to the facts required to be proved to sustain the judgment?

REASONS FOR GRANTING WRIT.

Your petitioner urges the following reasons for the allowance of the writ:

FIRST: That the said court has decided a Federal question, to-wit, a construction of Section 60b of the Bankruptcy Act of 1898, as amended to June 26, 1936, in a way which is untenable and probably in conflict with the decision of this court in Cunningham vs. Brown, 265 U. S. 1, by holding that it was necessary for a trustee in Bankruptcy, in order to prove a voidable preference, to establish that the one receiving the transfer had knowledge that it was intended as a preference, notwithstanding the plain and unambiguous language of the Bankruptcy Act then in effect that a transfer may be avoided by a trustee if the one receiving it or to be benefited thereby has reasonable cause to believe the enforcement of the transfer would effect a preference, thus laying down a rule which places upon a trustee a wholly unnecessary and unfair burden of proof, which does and will prevent the just and equitable distribution of bankrupt estates for the benefit of all the creditors.

SECOND: That the said court has rendered a decision in conflict with decisions on the same matter, to-wit, the construction of Section 60b of the Bankruptcy Act of 1898, as amended to June 26, 1936, of the Circuit Court of Appeals, for the Third Circuit, in the case of In Re Star Spring Bed Co., 265 Fed. 133, and of the Circuit Court of Appeals, for the Seventh Circuit, in the case of Musk, et al. v. Burk, 58 Fed. (2d) 77, and of the Circuit Court of Appeals, for

the Sixth Circuit, in the case of Buchanan State Bank v. De Groot, 39 Fed. (2d) 397, by holding in effect that it was necessary for the trustee in bankruptcy, in order to recover a voidable preference, to establish that the one receiving the preference had knowledge the debtor was insolvent at the time of the transfer, rather than "reasonable cause to believe" him insolvent as prescribed by the Bankruptcy Act, then in effect, and which the above cited cases and many others have held is established by notice of facts which would put a reasonably prudent person upon inquiry and of all the facts an inquiry would have developed and does not require either knowledge or actual belief that the debtor is insolvent. The effect of the decision here is to relieve a transferee of any duty of ever making an inquiry and is a wrongful construction of the plain language of the Bankruptcy Act above quoted and conflicts with the construction long placed thereon by other courts.

THIRD: That the said court has decided an important question of Federal law, to-wit, a construction of Rule 52, of the Federal Rules of Civil Procedure, which has not been, but should be, settled by this court, by, in effect, substituting its judgment on facts for that of the trial court in an action tried by the court without a jury and where it is shown by the opinion it had considered the evidence upon a wrongful hypothesis of the burden of proof placed upon the trustee and because of such wrongful hypothesis of the extent of the proof required has drawn different conclusions from the evidence from those drawn by the trial judge.

FOURTH: That the said court has so far departed from the accepted and usual course of judicial pro-

cedure as to call for an exercise of this Court's power of supervision, in that it has reversed the judgment of a trial court based on findings of fact covering all the issues and supported by competent evidence in an action tried by the court without a jury, for the recovery by a trustee in bankruptcy of a voidable preference, without an adequate examination and consideration of the testimony which was heard and considered by the trial court, as is evidenced by the recitations in its opinion of facts assertedly shown by the evidence in the record and which an examination of the record shows are erroneous, and has totally disregarded other material, competent and undisputed evidence. That it has also promulgated a rule contrary to the established rule of the proof which is required in order to recover a voidable preference, which rule, if allowed to stand, will make it practically impossible for a trustee in bankruptcy to recover voidable preferences.

WHEREFORE, your petitioner prays that a Writ of Certiorari may be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding the said court to certify and send to this Court for its review and determination, on a day certain to be designated therein, a full and complete transcript of the record of all proceedings in the said Circuit Court of Appeals in the said case entitled Valley National Bank, a banking corporation, appellant v. Stephen Westover, trustee in bankruptcy of Grand Avenue Lumber Company, a corporation, bankrupt, appellee, No. 9415; and that said decree of the Circuit Court of Appeals, made and entered in said cause, on the 22nd day of May, 1940 and as modified on the 19th day of June, 1940, may be reversed by this Honorable

Court and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just, and that your petitioner will ever pray, etc.

STEPHEN WESTOVER,
Trustee in Bankruptcy of Grand Avenue Lumber Company, a corporation, bankrupt, Petitioner.

By ALEXANDER B. BAKER,
His Counsel.

ALICE M. BIRDSALL,
Of Counsel for Petitioner.

INDEX TO SUPPORTING BRIEF